

092622

B-114860  
10-11-72



# REPORT TO THE CONGRESS

## Examination Of Financial Statements Of The National Flood Insurance Program Fiscal Year 1971 B 114860

Federal Insurance Administration  
Department of Housing and Urban Development

BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES

092622

OCT. 11, 1972

713627



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON D C 20548

B-114860

To the President of the Senate and the  
Speaker of the House of Representatives

This is our report on the examination of financial statements of the National Flood Insurance Program, Federal Insurance Administration, Department of Housing and Urban Development, for the fiscal year ended June 30, 1971.

Our examination was made pursuant to the Government Corporation Control Act (31 U.S.C. 841)

Copies of this report are being sent to the Director, Office of Management and Budget, the Secretary of the Treasury, the Secretary of Housing and Urban Development, and the Administrator, Federal Insurance Administration.

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General  
of the United General

C o n t e n t s

	<u>Page</u>
DIGEST	1
CHAPTER	
1    INTRODUCTION	3
2    DESCRIPTION OF INSURANCE COVERAGE	6
General information	6
Regular program	6
Emergency program	7
3    AGREEMENT WITH NATIONAL FLOOD INSURERS ASSOCIATION	9
4    SCOPE OF EXAMINATION	11
5    OPINION ON THE FINANCIAL STATEMENTS	12
6    AGENCY COMMENTS	14
FINANCIAL STATEMENTS	
Schedule	
1    National Flood Insurance Program combined balance sheet--June 30, 1971	17
2    National Flood Insurance Program combined statement of income and expense and cumulative deficit for fiscal year ended June 30, 1971	18
3    National Flood Insurance Program combined statement of source and application of funds for fiscal year ended June 30, 1971	19
Notes to combined balance sheet--June 30, 1971	20

APPENDIX

Page

I	National Flood Insurers Association public accountant's opinion of the financial statements of the National Flood Insurers Association	21
II	National Flood Insurers Association balance sheets at June 30, 1971 and 1970	22
III	National Flood Insurers Association statements of income and residual balance for the fiscal years ended June 30, 1971 and 1970	23
IV	National Flood Insurers Association statements of source and application of cash for the fiscal years ended June 30, 1971 and 1970	24
V	National Flood Insurers Association notes to financial statements--June 30, 1971	25
VI	Principal officials of the Department of Housing and Urban Development and the Federal Insurance Administration respon- sible for the administration of activi- ties discussed in this report	28

ABBREVIATIONS

FIA	Federal Insurance Administration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
IRS	Internal Revenue Service
NFIA	National Flood Insurers Association

D I G E S T

WHY THE EXAMINATION WAS MADE

The Government Corporation Control Act requires the General Accounting Office (GAO) to examine the financial statements of the National Flood Insurance Program

The National Flood Insurance Program is a two-part operation. The Federal Insurance Administration sets policy, establishes premium rates, designates areas eligible for insurance, and, for a fee, reinsures the insurers that sell flood insurance (See pp 3 to 8). The National Flood Insurers Association, a pool of 98 private insurance companies participating in the program under an agreement with the Secretary of Housing and Urban Development, conducts the day-to-day insurance activities, such as selling insurance, collecting premiums, and settling claims (See pp 9 and 10).

GAO examined the financial statements of both parts of the National Flood Insurance Program. GAO's examinations were made in accordance with generally accepted auditing standards and included tests of the accounting records and other procedures considered necessary.

OPINION ON FINANCIAL STATEMENTS

National Flood Insurance Program  
Federal Insurance Administration

In GAO's opinion, the combined bal-

ance sheet (sch 1), the combined statement of income and expense and cumulative deficit (sch 2), and the combined statement of source and application of funds (sch 3) present fairly the financial position of the National Flood Insurance Program administered by the Federal Insurance Administration, at June 30, 1971, and the results of its operation and the source and applications of its funds for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws (See p 12).

National Flood Insurers Association

The association's balance sheets (app II), the statements of income and residual balance (app III), and the statements of source and application of cash (app IV) omit the liability of \$1.1 million for Federal income tax and the corresponding Federal income tax expense. In GAO's opinion, because of the materiality of the amount of Federal income tax involved, the financial statements of the association do not present fairly its financial position at June 30, 1971, and the results of its operations and the source and application of cash for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by State regulatory

OCT. 11, 1972

authorities, applied on a consistent basis. These accounting principles vary in certain respects from generally accepted accounting principles as explained in the first two paragraphs of Note 1 of the Notes to the NFIA Financial Statements (app V) (See p. 13.)

AGENCY COMMENTS

The Department of Housing and Urban Development (HUD), the association, and its public accountant disagreed with GAO's opinion on the financial statements of the association and indicated their reasons for omitting the Federal income tax liability in the financial statements.

HUD and the association stated that the association's Federal income tax status was presently under consideration by the Internal Revenue Service and that the association would probably be declared a tax-exempt organization. The public accountant pointed out that its opinion on the financial statements was properly qualified on the basis of the association's views that the tax status

was pending and that a tax exemption would likely be received.

Because the association did not have a tax-exempt status at June 30, 1971--a prerequisite for not showing the tax liability in the financial statements--GAO's opinion on the financial statements is appropriate. (See pp. 15 and 16 )

RECOMMENDATIONS OR SUGGESTIONS

The report contains no recommendations or suggestions.

MATTERS FOR CONSIDERATION  
BY THE CONGRESS

This report is submitted to the Congress, as required by the Government Corporation Control Act, to show the results of GAO's examination of the financial statements of the National Flood Insurance Program and to make known to the Congress other information deemed necessary to keep it informed of the operations and financial condition of the program.

## CHAPTER 1

### INTRODUCTION

The National Flood Insurance Program was established under the National Flood Insurance Act of 1968 (42 U.S.C. 4011), which included a provision subjecting the program to the Government Corporation Control Act, thus making mandatory an annual audit by the Comptroller General. The 1968 act authorized the Secretary of Housing and Urban Development to establish and carry out a national flood insurance program and to encourage and assist insurance companies and other insurers to associate, or otherwise join together, in a pool to provide flood insurance coverage to property owners in flood-prone areas. The term "flood" includes inundation from mudslides caused by accumulation of water on or under the ground.

The Secretary delegated the administration of the program to the Administrator, Federal Insurance Administration (FIA), a Department of Housing and Urban Development (HUD) component which also administers programs that provide crime insurance and reinsurance against abnormal loss resulting from riots and civil commotion.

The National Flood Insurance Program is a subsidized Government-sponsored program designed to enable owners of real or personal property, in areas designated by the Administrator, FIA, as eligible for flood insurance, to purchase such insurance. Premium rates are established on an actuarial basis and, insofar as practicable, at a level sufficient to cover the estimated full cost of the insurance and to enable the accumulation of reserves to pay anticipated losses. To encourage the purchase of flood insurance, the Administrator can establish lower than full-cost rates--"chargeable rates"--and the difference between the chargeable rates and the full-cost actuarial rates is subsidized by the Federal Government.

The Secretary entered into an agreement with the National Flood Insurers Association (NFIA) to provide insurance coverage on a limited risk-sharing basis. (See p. 9.) The agreement describes NFIA as a voluntary, nonprofit, unincorporated association. At June 30, 1971, NFIA consisted of 98 private insurers.

The 1968 act authorized the Secretary to borrow up to \$250 million from the U S. Treasury on interest-bearing notes or other obligations to establish a National Flood Insurance Fund. The fund is available for (1) premium equalization payments to insurers (the difference between the actuarially determined, full-cost premium rates and the chargeable premium rates established by the Administrator, FIA, to encourage the purchase of flood insurance), (2) payment of claims of insurers which purchased reinsurance coverage from NFIA to cover excess flood insurance losses (in excess of agreed upon amounts), (3) financing of the total flood insurance program in the event that the joint Government-industry operation becomes unfeasible, (4) repayment to the Treasury for amounts borrowed together with interest, and (5) payment of such administrative expenses as the Secretary may deem necessary to carry out the flood insurance program.

Credits to the fund, in addition to borrowings from the Treasury, consist of (1) reinsurance premiums, (2) advances from appropriations to maintain the fund in an operative condition adequate to meet its liabilities, (3) interest earned on investments of the fund, and (4) any other receipts accruing from the insurance operations.

The 1968 act authorized the Secretary to study and investigate flood-prone areas to obtain information on the adequacy of State and local measures for land management and use, flood control, flood zoning, and flood damage prevention. The act directed the Secretary to use the information to develop comprehensive criteria designed to encourage, if necessary, the adoption of adequate State or local measures which, to the maximum extent feasible, would (1) lessen the exposure of property and facilities to flood losses, (2) improve the long-range land management and use of land in flood-prone areas, and (3) inhibit the unplanned and economically unjustifiable future development of land in flood-prone areas.

The 1968 act authorized, also, the appropriation of funds for administrative expenses of the Federal Government in carrying out the National Flood Insurance Program, including costs incurred in studies and investigations to establish premium rates, and in determining the areas eligible for flood insurance.

NFIA began to sell regular program flood insurance on June 25, 1969, after the Secretary had designated the first two communities eligible for flood insurance coverage. At June 30, 1971, 637 communities were eligible for flood insurance coverage. In regard to the future availability of regular program flood insurance, the 1968 act, as amended, provided that, after December 31, 1971, new flood insurance coverage would be available only in States or areas which had furnished the Secretary with satisfactory assurance that, by December 31, 1971, adequate land use and control measures, consistent with the comprehensive criteria prescribed, would be adopted. The 1968 act limited the amount of flood insurance that might be outstanding and in force at any given time to \$2.5 billion.

The Housing and Urban Development Act of 1969 (12 U.S.C. 1701 et seq.) amended the 1968 act to provide for any emergency flood insurance program for a 2-year period ended December 31, 1971, during which time the Secretary was authorized to provide flood insurance coverage at the Government-subsidized chargeable rate without first determining actuarial premium rates for individual areas. In December 1971 the 1968 act was further amended to extend the emergency insurance program to December 31, 1973.

## CHAPTER 2

### DESCRIPTION OF INSURANCE COVERAGE

#### GENERAL INFORMATION

The owner of real or personal property insured under the National Flood Insurance Program is indemnified for loss of, or damage to, his property resulting from naturally caused general floods but not for loss from water damage resulting from causes on his property or from conditions within his control.

Flood insurance policies are written for 1-year terms under both the regular and the emergency programs. When the Administrator, FIA, designates an area as eligible for flood insurance, NFIA designates a member company office as the servicing office for the eligible area. The servicing office was paid a \$15 fee for processing each application for insurance and for issuing the policy. On July 1, 1971, the fee was reduced to \$10. The agent securing the business is paid a commission of 15 percent of the annual premium.

An insurance policy is effective as of the date of an application, if the application is submitted within 30 days after an area has been designated as eligible for insurance. Thereafter a policy becomes effective 15 days after submission of an application for insurance. The full annual premium is payable at the time an application is made for insurance. The policy is renewable on the anniversary date, upon payment of the annual premium. A clause included in each policy specifies a deductible of \$200 for loss on a structure and \$200 for loss on the contents of a structure or 2 percent of the amount of the insurance coverage applicable to each type of loss, whichever is greater.

#### REGULAR PROGRAM

At June 30, 1971, insurance coverage under the regular program was available for residential structures designed for the occupancy of one to four families. Insurance coverage was not available for structures occupied by small businesses, because actuarially based premium rates for coverage on such structures had not been developed by the Administrator.

The limit on insurance coverage was \$35,000 for a single structure containing one dwelling unit, \$60,000 for a single structure containing more than one dwelling unit, and \$10,000 for the contents of each dwelling unit. When actuarially based premium rates are developed for small business properties, the limits of coverage will be \$60,000 for a single structure and \$10,000 for the contents of each small business located within the structure.

The annual premium for structures in existence before an area is eligible for insurance under the regular program is the lower of the actuarial or the chargeable rate for the first half of the insurance coverage plus the actuarial rate for the remaining half. The actuarial rate is charged for structures constructed in an area after it has been designated as eligible for regular program insurance.

At June 30, 1971, regular program insurance in force amounted to \$246 million.

#### EMERGENCY PROGRAM

At June 30, 1971, insurance coverage under the emergency program was available for residential structures containing one to four dwelling units and for structures occupied by small businesses.

The limits on insurance coverage for residential structures were half of the coverage available under the regular program, or \$17,500 for a single structure containing one dwelling unit, \$30,000 for a single structure containing more than one dwelling unit, and \$5,000 for the contents of each dwelling unit. The limits on insurance coverage for a single structure occupied by small businesses were \$30,000 for the structure and \$5,000 for the contents of each business located within the structure.

The chargeable premium rates for insurance under the emergency program are based on the value of the insured property and range from \$0.40 per \$100 of insurance coverage for single-family dwellings valued at \$17,500 or under to \$0.50 per \$100 of insurance coverage for multifamily dwellings valued at \$60,000 or over. Chargeable rates for contents range from \$0.50 to \$0.60 per \$100 of insurance

coverage. The chargeable rates for insurance coverage for small business properties range from \$0.50 per \$100 of insurance coverage for properties valued at \$30,000 or under to \$0.70 per \$100 of insurance coverage for properties valued at \$60,000 or over. The chargeable rate for contents is \$1 per \$100 of insurance coverage.

At June 30, 1971, emergency program insurance in force amounted to \$949 million.

## CHAPTER 3

### AGREEMENT WITH NATIONAL FLOOD INSURERS ASSOCIATION

The 1968 act authorized the Secretary to encourage and assist insurance companies to join together in a pool to (1) provide flood insurance coverage, (2) participate financially in underwriting the risks assumed, and (3) adjust and pay claims for flood losses. Pursuant to this authorization, the Secretary entered into an agreement with NFIA, described in the agreement as a voluntary, nonprofit, unincorporated association of private insurers. The agreement was effective for the accounting period June 6, 1969, through June 30, 1970, and is renewable annually unless otherwise agreed to or terminated. The agreement was renewed through June 30, 1973. Some of the significant terms of the agreement follow.

1. NFIA will provide a continuous program of flood insurance, and changes in its membership shall not affect the continuity of the program.
2. Flood insurance in force at any one time shall not exceed \$2.5 billion face amount, and NFIA shall provide a minimum of \$40 million in risk capital subscribed to by its member companies at inception of the first accounting period.
3. NFIA shall arrange for the issuance of policies as well as for investigation, adjustment, and settlement of all claims presented under the policies.
4. NFIA shall purchase excess loss insurance coverage from the National Flood Insurance Program. Premium payments shall be made quarterly at a provisional rate of 6 percent of the policyholders' premiums applicable to the quarter. The total premiums paid at the provisional rate shall be adjusted at the conclusion of the accounting period to an amount computed by the application of agreed upon inland and coastal rates to the policyholders' premiums emanating from insurance in force in the inland and coastal areas. Claims for excess-loss insurance

coverage shall be paid by the National Flood Insurance Program when the total of insured losses and operating costs, after deducting premium equalization payments in any accounting period, exceeds 125 percent of policyholder premiums.

5. NFIA may retain, or may distribute to the members of NFIA as an operating allowance, a part of operating profit earned in an accounting period in an amount not to exceed 5 percent of policyholder premiums applicable to the period. Operating profit in excess of 5 percent of the policyholder premiums shall be held in trust by NFIA and shall be used for payment of future losses, operating costs, and operating allowances. Pending expenditure, the funds shall be invested in fully guaranteed obligations of the United States.
6. If, in any accounting period, NFIA does not earn sufficient operating profit to enable it to pay an operating allowance to its members, NFIA is entitled to use the funds held in trust to make the payment.
7. The National Flood Insurance Program, using a formula set forth in the agreement to compute the amount, shall make periodic premium equalization payments to NFIA for the Government's share of flood insurance claims paid and for equalization operating costs.

## CHAPTER 4

### SCOPE OF EXAMINATION

Our examination of the financial statements of FIA pertaining to the National Flood Insurance Program for the fiscal year ended June 30, 1971, was made in accordance with generally accepted auditing standards and included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The HUD internal auditors did not examine the National Flood Insurance Program's accounting records pertaining to fiscal year 1971 operations; therefore, no internal audit work was available to enable us to reduce our tests of the program's accounting records.

The activities of NFIA are an integral part of the National Flood Insurance Program and are subject to audit by us pursuant to the Government Corporation Control Act. NFIA engaged a firm of public accountants to audit its financial statements. Our audit included observations and tests of the firm's work.

## CHAPTER 5

### OPINION ON THE FINANCIAL STATEMENTS

The financial statements of the National Flood Insurance Program, presented as schedules 1 through 3, were prepared by FIA.

In our opinion, the combined balance sheet (sch. 1), the combined statement of income and expense and cumulative deficit (sch. 2), and the combined statement of source and application of funds (sch. 3) present fairly the financial position of the National Flood Insurance Program at June 30, 1971, and the results of its operations and the source and application of its funds for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws.

The financial statements of NFIA are presented as appendixes I through V. The public accounting firm engaged by NFIA stated, in its opinion dated November 30, 1971, (see app. I), that

"The Association has filed an application under the appropriate section of the Internal Revenue Code to be recognized as a non-taxable association. To date, the requisite approval has not been received. If National Flood Insurers Association were to be deemed a taxable organization and taxed on a basis similar to that which currently applies to fire and casualty insurance companies, the resulting tax would have a material impact on its results of operations for the fiscal year ended June 30, 1971 and on its financial position at that date as reflected in the accompanying financial statements.

"In our opinion, subject to the determination of the matter discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of National Flood Insurers Association at June 30, 1971 and the

results of its operations for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by state regulatory authorities, applied on a consistent basis. These accounting principles vary in certain respects from generally accepted accounting principles as explained in Note 1 of the Notes to Financial Statements."

We do not concur with the opinion of the public accounting firm, because we do not agree that NFIA's tax status was subject to determination on June 30, 1971. On that date, NFIA was not a tax-exempt organization nor was a request for recognition as a tax-exempt organization pending with the Internal Revenue Service (IRS)

In December 1969, NFIA filed a request with IRS to be recognized as a nontaxable association. On May 28, 1971, NFIA advised IRS that it wished to withdraw consideration of whether the income of NFIA was tax exempt. On June 8, 1971, IRS notified NFIA that its request for a ruling was considered withdrawn and that the file on the matter was closed. A second request to be recognized as a nontaxable association was not filed by NFIA until August 21, 1972.

Thus, at June 30, 1971, NFIA was subject to Federal income taxes, and we estimate that its tax liability at that date amounted to about \$1.1 million. If the liability for the Federal income taxes had been recorded by NFIA, the total liabilities for fiscal year 1971 would be shown in appendix II as \$4.5 million instead of \$3.4 million and the residual balance would be shown as \$1.36 million instead of \$2.46 million. Also, the net income in appendix III would be shown as \$1.37 million instead of \$2.47 million because of the reduction of \$1.1 million to provide for the Federal income taxes.

Because of the materiality of the amount of the Federal income taxes, we are of the opinion that the financial statements of NFIA (apps. II, III, and IV) do not present fairly the financial position of NFIA at June 30, 1971, or the results of its operations for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by State regulatory authorities, applied on a consistent basis. These accounting principles vary in certain respects from generally accepted accounting principles as explained in the first two paragraphs of Note 1 of the Notes to the NFIA Financial Statements (app. V)

## CHAPTER 6

### AGENCY COMMENTS

HUD; NFIA; and Joseph Froggatt & Co., Inc., the public accounting firm engaged by NFIA, commented on a draft of this report and disagreed with our opinion on the NFIA financial statements. Following are pertinent sections taken from their comments.

#### HUD comments dated July 13, 1972

"We understand that there has been some difference of opinion as to whether a request for exemption from Federal income tax was pending at the date of the financial statements or on the date of the audit report by Froggatt & Company, Inc. Whatever the merits of the differing opinions, the Internal Revenue Service is presently considering the matter of the tax status of the Association \*\*\*."

HUD also expressed the view that it was never contemplated by the framers of the National Flood Insurance Act of 1968 that NFIA would be subject to Federal income taxes.

#### NFIA comments dated June 30, 1972

\*\*\* it is our contention that the NFIA tax status was subject to IRS determination on June 30, 1971 and continues to be subject to determination today. \*\*\*

"Another point to consider is that steps are continuing with the IRS to recognize NFIA's income as non-taxable. \*\*\*

"Consequently, on the basis of the opinions cited above, we cannot agree with the position taken by the General Accounting Office and that we feel that the presentation of the Financial Statements by Froggatt appears to be most practical to us "

Joseph Froggatt & Co., Inc., comments dated  
June 30, 1972

"We believe that our report dated November 30, 1971 properly sets forth our opinion on the financial statements examined. As you know, our opinion was a 'subject to opinion'. As such, the fairness of the financial statements was qualified to the extent that no final determination had been made as to the taxable or non-taxable status of the Association. We were advised that the Association intended to pursue the matter of obtaining tax exempt status through whatever channels were open to it. Its counsel was of the opinion, on which we relied, that the application requesting tax exempt status was still pending and the likelihood existed that such tax exemption would be received. (See Note 2 of the Notes to Financial Statements)."

\* \* \* \* \*

"With regard to the matter of whether the Association is or is not tax exempt, such determination has not yet been made. NFIA, through outside advisors, is pursuing discussions with Internal Revenue Service. To date, the latter has not made an examination of the Association nor has it rendered any opinion or tax assessment notice deemed to be adverse to the Association's best interests by its management."

We evaluated the comments submitted to us by HUD, NFIA, and Joseph Froggatt & Co., Inc. We considered the fact that NFIA did not have a tax-exempt status at June 30, 1971, and the material effect on the NFIA financial statements of not showing the liability for Federal income taxes and the related tax expense. The respondents did not dispute the fact that NFIA did not have tax-exempt status at June 30, 1971--a prerequisite, in our opinion, for not showing the tax liability in the financial statements.

Accordingly, our opinion on the financial statements of NFIA expressed on page 13 is appropriate.

SCHEDULE 1

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
 FEDERAL INSURANCE ADMINISTRATION  
 NATIONAL FLOOD INSURANCE PROGRAM  
 COMBINED BALANCE SHEET

June 30, 1971

ASSETS

	National Flood Insurance Fund	Appropriated Funds	Total
Cash and Fund Balances			
On deposit with U S Treasury	\$ 56,536 30	\$4,210,226 39	\$4,266,762 69
Accounts receivable-net	<u>197,876 00</u>	<u>-0-</u>	<u>197,876 00</u>
Total assets	<u>\$ 254,412 30</u>	<u>\$4,210,226 39</u>	<u>\$4,464,638 69</u>

LIABILITIES

Accounts Payable			
Studies and surveys - Government	\$ -0-	\$1,059,909 70	\$1,059,909 70
Studies and surveys - Other	-0-	70,413 94	70,413 94
Accrued interest payable	<u>29,918 75</u>	<u>-0-</u>	<u>29,918 75</u>
Total liabilities	<u>29,918 75</u>	<u>1,130,323 64</u>	<u>1,160,242 39</u>

INVESTMENT OF THE U S GOVERNMENT

Notes payable to the U S Treasury	1,060,333 40	-0-	1,060,333 40
Congressional appropriations (net of \$894,092 60 returned to the U S Treasury)	-0-	8,034,407 40	8,034,407 40
Cumulative deficit	<u>835,839 85</u>	<u>4,954,504 65</u>	<u>5,790,344 50</u>
Investment of U S Government	<u>224,493 55</u>	<u>3,079,902 75</u>	<u>3,304,396 30</u>
Total liabilities and investment of U S Government	<u>\$ 254,412 30</u>	<u>\$4,210,226 39</u>	<u>\$4,464,638 69</u>

The notes are an integral part of this statement

BEST DOCUMENT AVAILABLE

SCHEDULE 2

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

FEDERAL INSURANCE ADMINISTRATION  
 NATIONAL FLOOD INSURANCE PROGRAM  
 COMBINED STATEMENT OF INCOME AND EXPENSE AND CUMULATIVE DEFICIT  
 FOR FISCAL YEAR ENDED JUNE 30, 1971

	<u>National Flood Insurance Fund</u>	<u>Appropriated Funds</u>	<u>Total</u>
<b>Income</b>			
Reinsurance premiums	\$ 858,490 50	\$ -0-	\$ 858,490 50
Total income	<u>858,490 50</u>	<u>-0-</u>	<u>858,490 50</u>
 <b>Expense</b>			
Interest expense	39,477 33	-0-	39,477 33
Premium equalization payments	1,548,043 22	-0-	1,548,043 22
Administrative expense	-0-	587,000 00	587,000 00
Studies and survey expenses	<u>-0-</u>	<u>2,203,375 98</u>	<u>2,203,375 98</u>
Total expense	<u>1,587,520 55</u>	<u>2,790,375 98</u>	<u>4,377,896 53</u>
 Net loss for the fiscal year	729,030 05	2,790,375 98	3,519,406 03
Deficit at June 30, 1970	<u>106,809 80</u>	<u>2,164,128 67</u>	<u>2,270,938 47</u>
Cumulative deficit at June 30, 1971	<u>\$ 835,839 85</u>	<u>\$4,954,504 65</u>	<u>\$5,790,344 50</u>

BEST DOCUMENT AVAILABLE

SCHEDULE 3

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
 FEDERAL INSURANCE ADMINISTRATION  
 NATIONAL FLOOD INSURANCE PROGRAM  
 COMBINED STATEMENT OF SOURCE AND APPLICATION OF FUNDS  
 FOR FISCAL YEAR ENDED JUNE 30, 1971

	<u>National Flood Insurance Fund</u>	<u>Appropriated Funds</u>	<u>Total</u>
<b>Source of Funds</b>			
Borrowing from U S Treasury	\$1,008,388 39	\$ -0-	\$1,008,388 39
Congressional appropriations	-0-	5,000,000 00	5,000,000 00
Reinsurance premiums	<u>858,490 50</u>	<u>-0-</u>	<u>858,490 50</u>
Total source of funds	<u>\$1,866,878 89</u>	<u>\$5,000,000 00</u>	<u>\$6,866,878 89</u>
<b>Application of Funds</b>			
Congressional appropriations returned to U S Treasury	\$ -0-	\$ 13,202 60	\$ 13,202 60
Interest expense	39,477 33	-0-	39,477 33
Premium equalization payments	1,548,043 22	-0-	1,548,043 22
Administrative expense	-0-	587,000 00	587,000 00
Studies and surveys	-0-	2,203,375 98	2,203,375 98
Increase in working capital	<u>279,358 34</u>	<u>2,196,421 42</u>	<u>2,475,779 76</u>
Total application of funds	<u>\$1,866,878 89</u>	<u>\$5,000,000 00</u>	<u>\$6,866,878 89</u>

BEST DOCUMENT AVAILABLE

NOTES TO COMBINED BALANCE SHEET

June 30, 1971

As of June 30, 1971, the National Flood Insurance Program was contingently liable for (1) its share of flood insurance losses (equalization losses) that the National Flood Insurance Association may pay on the insurance in force at June 30, 1971, in the event of a flood and (2) its share of the costs that may be incurred by the National Flood Insurers Association to settle the flood insurance loss claims in connection with the insurance in force at June 30, 1971. The amount of the contingent liability is not readily ascertainable since flood losses, if any, will be contingent upon the occurrence, extent, and severity of floods in the areas covered by flood insurance.

The National Flood Insurers Association purchased excess loss insurance from the National Flood Insurance Program. As of June 30, 1971, the National Flood Insurance Program is contingently liable for excess losses that the National Flood Insurers Association may incur for the insurance in force at June 30, 1971. The amount of the contingent liability is not readily ascertainable since it is contingent upon the occurrence, extent, and severity of floods in the areas covered by flood insurance. The method for computing the amount of excess loss is provided in the agreement between National Flood Insurers Association and the Secretary of HUD.

BEST DOCUMENT AVAILABLE

# JOSEPH FROGGATT & Co INC

ACCOUNTANTS AND AUDITORS

74 TRINITY PLACE

NEW YORK, N Y 10006

Executive Committee  
National Flood Insurers Association  
New York, New York

We have examined the accompanying balance sheet of National Flood Insurers Association as of June 30, 1971 and the related statements of income and residual balance and source and application of cash for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, except that we did not confirm the amount due from the United States Government, Department of Housing and Urban Development, as to which amount we satisfied ourselves by means of other auditing procedures. We previously examined and reported upon the Association's balance sheet at June 30, 1970 and the related statement of income and residual balance for the fiscal period then ended.

The Association has filed an application under the appropriate section of the Internal Revenue Code to be recognized as a non-taxable association. To date, the requisite approval has not been received. If National Flood Insurers Association were to be deemed a taxable organization and taxed on a basis similar to that which currently applies to fire and casualty insurance companies, the resulting tax would have a material impact on its results of operations for the fiscal year ended June 30, 1971 and on its financial position at that date as reflected in the accompanying financial statements.

In our opinion, subject to the determination of the matter discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of National Flood Insurers Association at June 30, 1971 and the results of its operations for the fiscal year then ended, in conformity with accounting principles prescribed or permitted for insurance companies by state regulatory authorities, applied on a consistent basis. These accounting principles vary in certain respects from generally accepted accounting principles as explained in Note 1 of the Notes to Financial Statements.

JOSEPH FROGGATT & CO , INC

By Roy W. Johnson  
Vice President

New York, New York  
November 30, 1971

APPENDIX II

NATIONAL FLOOD INSURERS ASSOCIATION

BALANCE SHEETS

At June 30, 1971 and 1970

<u>ADMITTED ASSETS</u>	<u>1971</u>	<u>1970</u>
<b>CASH AND INVESTMENTS</b>		
Cash in bank and office		
In office awaiting deposit	\$ 91,445 82	\$ -0-
Demand deposits	398,923 68	370,091 66
Time deposits	1,600,000 00	-0-
	<u>2,090,369 50</u>	<u>370,091 66</u>
Investments at cost		
Treasury bills	2,752,912 95	-0-
Bankers acceptances	292,162 50	-0-
	<u>3,045,075 45</u>	<u>-0-</u>
Total	<u>5,135,444 95</u>	<u>370,091 66</u>
<b>OTHER ASSETS</b>		
Premium balances	214,780 00	390,325 10
Accrued interest	42,285 37	-0-
Equalization operating costs receivable and accrued - due from United States Government, Department of Housing and Urban Development	416,050 61	178,711 14
Other assets	44,778 00	-0-
Total	<u>717,893 98</u>	<u>569,036 24</u>
Total admitted assets	<u>\$5,853,338 93</u>	<u>\$939,127 90</u>
<b><u>LIABILITIES AND RESIDUAL BALANCE</u></b>		
<b>LIABILITIES</b>		
Losses - Note 3	\$ 42,300 00	\$ -0-
Loss adjustment expenses - Note 3	5,000 00	-0-
Unearned premiums	2,319,109 00	631,136 00
Federal income tax - Note 2	-0-	-0-
Accounts and expenses due or accrued		
Service fees	357,795 00	166,320 00
Loss drafts payable	5,301 02	-0-
Reinsurance premiums	613,927 26	125,361 89
Other liabilities	52,100 64	25,750 45
Unallocated claim expenses	1,745 37	-0-
Total liabilities	<u>3,397,278 29</u>	<u>948,568 34</u>
<b>RESIDUAL BALANCE - Note 4</b>		
Membership fees refundable	83,202 00	83,002 00
Undistributed income (loss)	2,372,858 64	(92,442 44)
	<u>2,456,060 64</u>	<u>(9,440 44)</u>
Total liabilities and residual balance	<u>\$5,853,338 93</u>	<u>\$939,127 90</u>

These statements should be read in conjunction with the Notes to Financial Statements which are made a part hereof

## NATIONAL FLOOD INSURERS ASSOCIATION

## STATEMENTS OF INCOME AND RESIDUAL BALANCE

For the Fiscal Years Ended June 30, 1971 and 1970

	1971	1970
<b>INCOME</b>		
Gross premiums written	\$5,882,687 00	\$832,480 55
Less - Reinsurance premiums	<u>858,490.76</u>	<u>125,361 89</u>
Net premiums written	5,024,196 24	707,118 66
Change in unearned premium reserve	<u>1,687,973 00</u>	<u>631,136 00</u>
Net premiums earned	3,336,223 24	75,982 66
Investment income earned	<u>133,572 25</u>	<u>-0-</u>
Total income	<u>3,469,795 49</u>	<u>75,982 66</u>
<b>EXPENSES</b>		
Commissions	<u>837,579 13</u>	<u>124,870 12</u>
Equalization operating costs		
Service fees	1,129,664 80	172,920 00
General expenses	249,510 66	101,291 13
Losses	293,618 15	-0-
Loss expenses	<u>42,164 50</u>	<u>-0-</u>
	1,714,958 11	274,211 13
Less - Recovered from United States Government, Department of Housing and Urban Development	<u>1,548,042 83</u>	<u>230,656 15</u>
	166,915 28	43,554 98
Net expenses	<u>1,004,494 41</u>	<u>168,425 10</u>
Net income (loss) before taxes	2,465,301 08	(92,442 44)
FEDERAL INCOME TAX - Note 2	<u>-0-</u>	<u>-0-</u>
NET INCOME (LOSS)	<u>2,465,301 08</u>	<u>(92,442 44)</u>
<b>RESIDUAL BALANCE - Note 4</b>		
Residual balance (deficit) - beginning of period	(9,440 44)	-0-
Membership fees received	<u>200 00</u>	<u>83,002 00</u>
	<u>(9,240 44)</u>	<u>83,002 00</u>
Residual balance (deficit) - end of period	<u>\$2,456,060 64</u>	<u>\$ (9,440 44)</u>

These statements should be read in conjunction with the Notes to Financial Statements which are made a part hereof

# APPENDIX IV

## NATIONAL FLOOD INSURERS ASSOCIATION

### STATEMENTS OF SOURCE AND APPLICATION OF CASH

For the Fiscal Years Ended June 30, 1971 and 1970

	<u>1971</u>	<u>1970</u>
<b>SOURCE OF CASH</b>		
Net income (loss)	\$2,465,301 08	\$(92,442 44)
Non-cash charges and credits		
Premium balances	175,545 10	(390,325 10)
Accruals and prepayments	(324,402 84)	(178,711 14)
Unearned premiums	1,687,973 00	631,136 00
Losses and loss adjustment expense reserves	47,300 00	-0-
Accounts and expenses due or accrued	<u>713,436 95</u>	<u>317,432 34</u>
Membership fees received	4,765,153 29	287,089 66
	<u>200 00</u>	<u>83,002 00</u>
Total	<u>4,765,353 29</u>	<u>370,091 66</u>
<b>APPLICATION OF CASH</b>		
Increase in investments - net		
Treasury bills	2,752,912 95	-0-
Bankers acceptances	<u>292,162 50</u>	<u>-0-</u>
Total	<u>3,045,075 45</u>	<u>-0-</u>
<b>INCREASE IN CASH BALANCE</b>		
CASH BALANCE - beginning of period	1,720,277 84	370,091 66
	<u>370,091 66</u>	<u>-0-</u>
CASH BALANCE - end of period	<u>\$2,090,369 50</u>	<u>\$370,091 66</u>

These statements should be read in conjunction with the Notes to Financial Statements which are made a part hereof

## NATIONAL FLOOD INSURERS ASSOCIATION

## NOTES TO FINANCIAL STATEMENTS

June 30, 1971

NOTE 1 - BASIS OF PRESENTATION

National Flood Insurers Association (also referred to as the "Association" or "NFIA" in these notes), is a voluntary, unincorporated association of insurers, which began operations on June 6, 1969, pursuant to the National Flood Insurance Act of 1968

The accompanying financial statements have been prepared in accordance with the requirements of the Insurance Department of the State of New York which include, among others, the immediate charge to income of the cost of acquiring new business while the related premium income is deferred over the periods covered by the policies. The effect of this requirement on the accompanying financial statements has not been determined.

The statements herein differ from those submitted by the Association to its member companies. Premiums and the related acquisition costs are reported to NFIA by a number of servicing companies, and consequently a delay in recording the resulting transactions is inherent to the operations of the Association. In the accompanying statements effect has been given to transactions reported through September 30, 1970 and applicable to the fiscal period ended June 30, 1970. For the fiscal year ended June 30, 1971 effect has been given to transactions reported through September 30, 1971 in both the Association's statements and in the accompanying statements. Following is a reconciliation between amounts previously reported to member companies and amounts reported herein:

	Net Underwriting Gain (Loss)	
	1971	1970
Reported by Association	\$2,410,133 39	\$(29,241 85)
Adjustments		
Premiums	(459,206 00)	459,206 00
Commissions	68,880 90	(68,880 90)
Reinsurance premiums	102,965 42	(102,965 42)
Service fees	90,255 00	(90,255 00)
Expenses accrued	8,710 67	(8,710 67)
Unearned premiums	332,136 00	(332,136 00)
Equalization payments	(88,574 30)	88,574 30
Adjustment for amount due from HUD	-0-	(8,032 90)
	55,167 69	(63,200 59)
Reported herein	\$2,465,301 08	\$(92,442 44)

## NOTES TO FINANCIAL STATEMENTS

June 30, 1971

NOTE 2 - FEDERAL INCOME TAXES

NFIA has filed an application under the appropriate section of the Internal Revenue Code to be recognized as a non-taxable association. To date the Association has not received the requisite declaration to be so recognized. Counsel for NFIA is of the opinion that the matter of this application is still pending and the likelihood exists that the Association will be declared to be an organization exempt from Federal income taxes.

Should the Association be denied non-taxable status and its taxable income computed on a basis similar to that currently applicable to fire and casualty insurance companies, the resulting income tax would have a material impact on the Association's operating results for the fiscal year ended June 30, 1971 and its financial position as of that date.

NOTE 3 - LOSS RESERVES

The estimated liability for losses and loss adjustment expenses is necessarily based on estimates and no representation is made that the ultimate liability may not exceed such estimates. The estimates are reviewed continuously during the year and changes therein are reflected in operating results currently.

NOTE 4 - RESIDUAL BALANCE

Pursuant to an agreement between the Association and the Secretary of Housing and Urban Development, restrictions are applicable to the disposition of positive operating balances (profits) resulting from NFIA's operations. Among others, such restrictions limit to 5% of each year's policyholder premiums the amount of profits which may be retained and used by the Association in accordance with the terms of its Constitution. Amounts in excess of the aforementioned limitation must be held in trust by the Association for the payment of future losses, operating and other costs. See Note 2 in respect of Federal income taxes.

Operating results for the participation year ended June 30, 1970 have been closed and, accordingly, the distribution due member companies, once approved by the Executive Committee, will amount to approximately \$42,000.

NOTE 5 - COMMITMENTS AND CONTINGENCIES

The Association is a party to an agreement with the Secretary of Housing and Urban Development. The agreement provides, among other matters, for reinsurance on an excess of loss basis of the business underwritten by NFIA, and places certain restrictions on the profits which inure to the benefit of the Association's member insurance companies (see Note 4). This agreement may be terminated by either party upon written notice to the other on or before January 31 of any accounting period, and termination, if it should eventuate, becomes effective at the end of the Association's accounting period (June 30).

## NOTES TO FINANCIAL STATEMENTS

June 30, 1971

---

NOTE 5 - COMMITMENTS AND CONTINGENCIES (Cont'd)

NFIA has also entered into a service agreement with Insurance Services Office (ISO) whereby the latter performs the necessary administrative functions for the former, subject to the overall direction of the NFIA Executive Committee. The services under this agreement are billed to the Association at ISO's cost. The agreement may be canceled by either party on sixty (60) days' written notice, or at any time by mutual consent.

Reference is here made to Note 2 in respect of Federal income taxes.

NOTE 6 - EVENTS SUBSEQUENT TO JUNE 30, 1971

Subsequent to June 30, 1971, as a result of tropical storm Doria, flood damage affected a substantial number of properties covered by policies issued by the Association. Management estimates that losses incurred by NFIA as a result of this storm will be approximately \$1,500,000.

APPENDIX VI

PRINCIPAL OFFICIALS OF  
THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
AND THE FEDERAL INSURANCE ADMINISTRATION  
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF HOUSING AND URBAN DEVELOPMENT: George W. Romney	Jan. 1969	Present
ADMINISTRATOR, FEDERAL INSURANCE ADMINISTRATION: George K. Bernstein	May 1969	Present

Copies of this report are available from the U S General Accounting Office, Room 6417, 441 G Street, N W , Washington, D C , 20548

Copies are provided without charge to Members of Congress, congressional committee staff members, Government officials, members of the press, college libraries, faculty members and students. The price to the general public is \$1.00 a copy. Orders should be accompanied by cash or check.